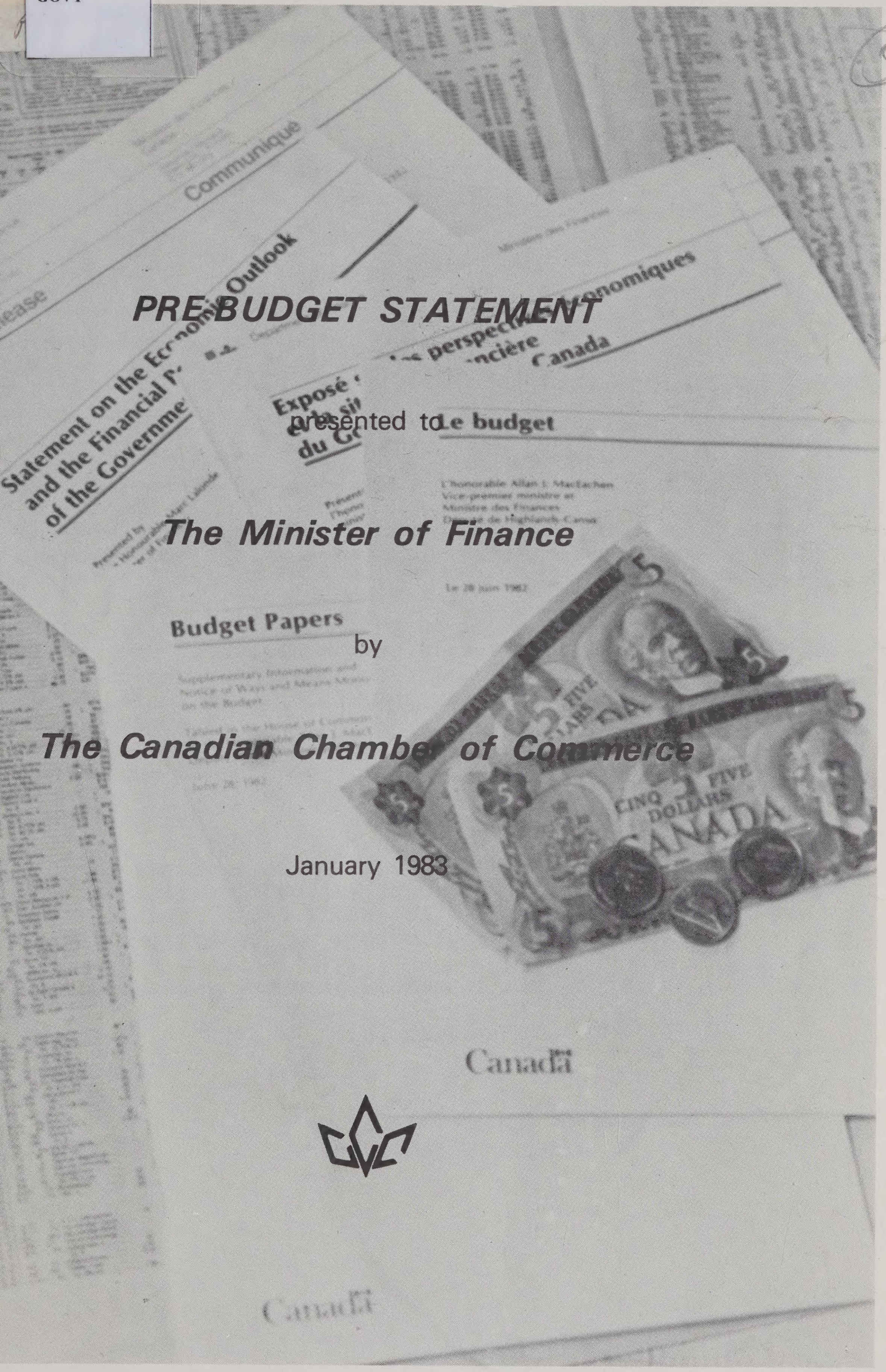


PRE-BUDGET STATEMENT

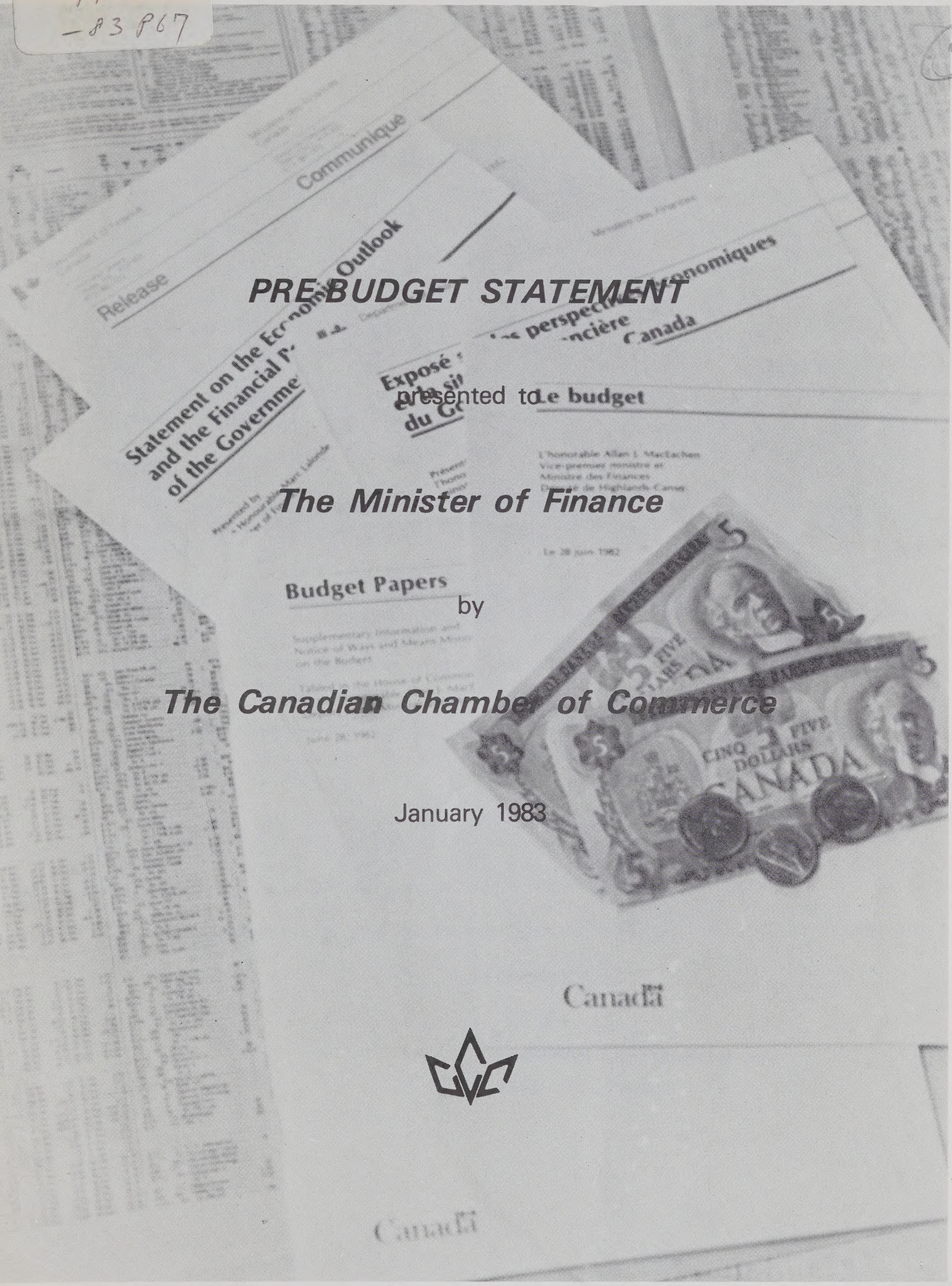
presented to

The Minister of Finance

by

The Canadian Chamber of Commerce

January 1983



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THE CANADIAN CHAMBER OF COMMERCE
200 ELGIN STREET • SUITE 301 • OTTAWA, ONTARIO K2P 2J7 • (613) 238-4000

OFFICE OF THE PRESIDENT

January 12, 1983

The Honourable Marc Lalonde, P.C., M.P.
Minister of Finance
Room 515-S
House of Commons
Ottawa, Ontario K1A 0A6

Dear Mr. Lalonde,

As you have requested, the Canadian Chamber of Commerce has prepared for you, and for your officials, a "pre-Budget statement".

This statement, reflecting as it does the views of the Chamber on the current economic situation and the probabilities for the near-term, presents our recommendations for fiscal policy decisions as you consider your options in anticipation of a Spring Budget.

We recognize the very limited areas for maneuver that are open to you and we have designed our presentation to fit within those constraints.

Representatives of our Economic Policy Committee would welcome an early opportunity to meet with you to discuss these recommendations. David Gibson will contact Doug Richardson and Bill Haney shortly to fix a date for such a meeting.

Please accept the best wishes of all of us for the New Year.

Sincerely,

Samuel F. Hughes

THE CANADIAN CHAMBER OF COMMERCE
200 ELGIN STREET • SUITE 301 • OTTAWA, ONTARIO K2P 2J7 • (613) 238-4000

As Canadians are painfully aware and contrary to virtually all forecasts, economic conditions in Canada have continued to deteriorate markedly during the second half of 1982. In our judgement, this deterioration is of such a magnitude that certain changes in economic policy, recently seen as desirable, have now become virtually imperative. Since one of the most important preconditions for any policies to be successful is the confidence of the business community that these measures are reasonable and appropriate, we welcome your willingness to listen, before you draft your budget, to the recommendations of Canada's largest and most representative business organization, The Canadian Chamber of Commerce.

Before outlining our policy recommendations, we would like to take a few paragraphs to present our assessment of <u>both</u> the near-term economic outlook and our longer-term prospects. We do so because the Chamber feels that, while present economic conditions obviously are not satisfactory, it is absolutely essential that our longer-term problems not be overlooked in any effort to improve the near-term outlook. It is our firm belief that, to be successful, any policies adopted to deal with the current recession <u>must</u> be compatible with the need to correct some fundamental long-term problems in the economy.

Since our policy recommendations have been formulated with this dual objective in mind, we feel that they can only be evaluated against the background of a comprehensive summary of what we feel the near-term and long-term issues to be.

THE NEAR-TERM OUTLOOK

It is now clear that the current recession is by far the worst since the end of World War II. As such, it has resulted in a more severe decline in economic activity throughout Canada - it has affected fisheries and shipbuilding in the Maritimes, manufacturing in central Canada and the resource industries of western Canada. In addition to being severe and widespread, equally disturbing is the fact that the recession will last longer than almost all observers had expected even a few months ago. It now seems virtually certain that, when the final quarter's figures are in, real output will have been found to have declined by about 5 percent in 1982. We already know that unemployment has soared to record post-depression levels, and with the current published rate at 12.7 percent, the average rate for the year is certain to exceed 11 percent. Even that high figure is likely to climb in 1983, with a distressing 13 percent plus unemployment rate for the 12-month average not impossible.

In our judgement, there are two aspects to the recession that have to be recognized before acceptable policies can be formulated to deal with the problem. These aspects are first, the international elements, resulting from our interdependence with the rest of the world economy and, second, the uniquely Canadian factors which, in our view, have served to make the recession here in Canada more severe than it is in the United States or many of the countries in Europe.

The key features of these two contributing factors can be summarized briefly:

1. The International Aspects

It is certainly true that a part of the recession here in Canada is a result of the economic downturn simultaneously underway in the rest of the world. With 25-30 percent of our GNP tied directly to exports, there is no way Canada can avoid being adversely affected by poor economic performance among our trading partners, especially in the United States. In our judgement, to try to insulate Canada from these international effects is impractical. As we learned in 1974-75, regardless of the laudatory nature of the objective, such a policy inevitably results in longer-term problems - especially high inflation and declining international competitiveness - much more serious than the short-term difficulties the policy of insulation was intended to correct.

2. Uniquely Canadian Aspects

While the Chamber recognizes that a part of our current recession is imported, it is also true that there are several uniquely Canadian problems that are making the recession here much worse than it is in most other OECD countries, including the United States. We believe that the most important "made-in-Canada" elements of our recession are the twin losses of consumer and business confidence. The two other uniquely Canadian aspects of our current economic difficulties that deserve mention are the weakness and vulnerability of our resource sector and rising unit labour costs. These problems are discussed in greater detail below:

a. The unprecedented weakness in consumer confidence, which in turn has resulted in an unprecedented weakness in consumer spending. As surveys show, consumer confidence in Canada is much lower than in the United States, and, as a result, Canadian consumers are reducing their spending far more than the decline in incomes would normally warrant.

b. The equally unprecedented weakness in business confidence, which has resulted in extreme weakness in investment spending, again far more than would normally be expected from the decline in economic activity. To be sure, numerous economic factors have contributed to the decline in business confidence. Reduced demands brought about by the recession as well as high interest rates have cut deeply into business profitability (corporate profits will probably have declined by about 30 - 40 percent during 1982). Inventory to shipments ratios are still too high in many key industries, as consumer spending remained weak throughout the year. Not surprisingly, capacity utilization has plummeted to record low levels. Capacity utilization in the manufacturing sector dropped to about 67 percent in mid-1982. Given these difficulties, businesses have been retrenching in an effort to survive.

However, while economic conditions were the most important factors causing the drop in business confidence, it is also clear that government policies have been a major contributing factor. Confirming this, in a recent survey, the Conference Board of Canada, found that nearly 50 percent of Canada's senior executives cited "government policies" as representing major impediments to increased investment.

c) The weakness and vulnerability of our resource sector. The resource advantage possessed by Canada in the 1960's and through the mid-1970's is now gone. The demand for many of the natural resources we produce is down, while costs are up, thereby reducing our competitiveness in world markets. In addition, governments have been too optimistic in their assessment of the level of taxation that can be supported by the resource industries. As a result, overtaxation has undermined the ability of these industries to undertake the investment needed to modernize and improve productivity, thereby either restoring their international competitiveness, or, in the case of already competitive industries like oil and gas, increasing production to displace imports in the Canadian market.

d) Canada's ability to compete against other countries has been undermined by a sharp rise in unit labor costs. This has been largely brought about by what in retrospect have been unduly generous wage settlements and disappointing productivity performance through most of the last ten years. This, in turn, has contributed to domestic problems - notably inflation - and, over the decade required a massive drop in the exchange rate. In the last two years our ability to compete has been further affected by the appreciation of the Canadian dollar against the currencies of our major European competitors.

Clearly, to improve our competitive position, we must make significant strides in our productivity. In the long-run, steady reliance on devaluations in an attempt to maintain international competitiveness -- in the face of steadily rising domestic costs -- is, as we have seen, a losing game, and we must breakout of the cycle.

The Outlook for 1983

Against this background, the economic outlook we now project is not optimistic. The recovery in the United States looks to be later and weaker than anyone had expected last October. In addition, the uniquely Canadian problems just discussed suggest a weaker than usual Canadian response to the United States recovery. Since so much of the outlook depends on that intangible factor - confidence, there is greather-than usual uncertainty in any specific numerical forecast. Thus, there is no precise agreement on the exact numbers to put in an outlook. In general, however, our economists expect definitely no better than 2 - 2½ percent real growth in 1983. In fact a clear majority on our Economic Policy Committee expects the economy to be much weaker than that, with real GNP growth in the 0 - 1 percent range for 1983. While the majority recognizes some upside potential (in the fact of the high savings rate which could finance a stronger recovery) if consumer confidence rose enough to trigger spending, its feeling is that this is unlikely to come early enough in the year in any event to have much of an impact.

Accompanying the low real growth rate will be a high unemployment rate. Specifically, the published unemployment rate is virtually certain to remain above the 1982 average of 11 percent - probably more like 13 percent - through all of 1983. Since no policy can have much of an impact before next fall at the earliest, there is little point in continuing to target for an 11 percent unemployment rate. We simply cannot reasonably expect to get there in 1983.

To be fair, we should point out that we do see some positive signals beginning to emerge. One key signal is that inflation is beginning to come down. The Consumer Price Index increased by less than 10 percent year over year this November -- the first time in two and one-half years that the Consumer Price Index was at the single digit level. Overall the inflation rate for 1982, as measured by the CPI, will probably be about 11 percent, which compares favourably with last year's 12.5 percent rate. Moreover, most forecasters expect the decline to continue in 1983.

The outlook for wage restraint also appears to be more optimistic than in the recent past. Spurred on by the deepening recession, wage settlements have finally began to de-escalate and private-sector wages in 1983, when the total compensation bill is used as the measure, may well fall within the government's "6 and 5" guidelines. We should also like to point out that while the Chamber is in support of the government's "6 and 5" program, it is important to note that economic conditions are forcing many companies to actually freeze wages, or, in some instances, actually to reduce them. If in fact private sector wages fall at or below "6 and 5" targets, we trust the 5 percent limit for 1983 will be taken as a ceiling in the public sector, and not as a floor.

Finally, high personal savings could also provide a positive stimulus to the economy. The personal savings rate in Canada is currently running at about 14 percent of personal disposable income (vis-a-vis the U.S. figure of 5 percent). Certain of these savings represent purchasing power that could be tapped, under the right circumstances, and that could fuel economic recovery.

Unfortunately, notwithstanding these positive signs, the "bottom line" is still that the near-term outlook is very bleak. Clearly, some policy response is appropriate. Before specifying what this response should be, however, we would like to review the significant long-term problems that still exist. This is important since any policies that attempt to deal with our short-term problems without at the same time being consistent with our longer-term needs are doomed to failure. They will fail because they would only exacerbate the confidence problems that we have already indicated are our most significant uniquely Canadian problems, and would result in even greater economic problems within a year or two.

THE LONG-TERM

Essentially, Canada's long-term economic problems are structural. There is considerable overlap with our short-term problems, however, so there is scope for consistent policies. The key structural problems the Chamber sees are:

1. The large federal deficit that will still exist at full employment - probably $4 - 6 billion, or 2 - 3 percent of GNP.

2. An embedded inflation rate higher than that of most of our OECD partners, and -- more worrisome -- higher than that of our principal trading partner, the United States.

3. An inappropriate monetary and fiscal policy mix. In general, monetary policy has had to bear too much of the burden of fighting inflation with little or no help from fiscal policy. (For the record, what is needed, we believe, are fiscal policies that will permit the lowest possible interest rates consistent with no inflation. Thus we urge the government to follow fiscal and monetary policies that complement one another rather than, as has been the case in the past, undermine one another.)

4. Disappointing productivity performance

5. The loss of our cost advantage for our resource industries.

6. The fact that business confidence in the government's commitment to private enterprise as the main engine of economic growth in Canada is extremely low.

WHAT NEEDS TO BE DONE

Clearly, the Canadian economy must overcome serious difficulties before recovery can be achieved. With business and consumer confidence expected to remain weak, unless your forthcoming budget takes dramatic steps to increase confidence, recovery is not expected to occur until late in 1983 at best. A great deal depends on the strength of the U.S. recovery and the overall prognosis at the moment is worrisome. However, while a full-scale recovery here must await a revival of economic activity in the United States, and will lag behind that recovery, there is much that could be done to improve the situation in Canada. This would at least bring our recession in line with the economic decline elsewhere rather than leave us much worse off than are our trading partners.

Fiscal Policy

In view of the unusual severity of the recession, the Canadian Chamber of Commerce has come to the conclusion that some direct stimulus of the economy by the government is warranted. Given both the size of the deficit, and the need for short-term measures to be consistent with long-term needs, however, we feel that <u>any initiative should be limited in scope and have an explicit termination date</u>. This would ensure that the stimulative efforts would not become permanent and therefore would not add to the deficit on a continuing basis -- even once the economy recovers from the current recession.

On this basis, we find a reduction in the retail sales tax for, say, six months, to be a particular attractive option. While we recognize the political difficulties involved, we believe that such a reduction would be especially effective both in reducing inflation and improving growth prospects.

A recent study by Chase Econometrics Canada, for example, suggests that a sales tax cut in the order of $2 billion would both add one percentage point to real growth in Canada next year and would also reduce the inflation rate by one percentage point.

For even greater effectiveness, we would favour focusing the tax cut on big-ticket, durable or semi-durable products. Not only would this represent a more visible incentive to consumers than a smaller, across-the-board tax reduction, but by selecting items with a high Canadian content, the external leakage effect could also be reduced and the benefits to Canadian employment and businesses increased.

Since a reduction in the retail sales tax would require a cooperative federal-provincial effort, it would be appropriate, we believe, to invite (but not to require) the provinces to match whatever federal funds are provided with additional provincially funded tax reductions.

As an additional source of stimulus, the Chamber recommends that the government accompany the sales tax reduction with an amendment to the RHOSP program to revert to the earlier policy of allowing funds to be withdrawn without tax penalty if the receipts are spent on home furnishings, as well as directly on a new house. If matched with the sales tax reduction, this would further boost consumer spending, and, since these deposits are not taxed currently, this would be accomplished at no further revenue cost to the government.

In general, the Chamber is opposed to most of the temporary make-work types of projects that have been proposed to help alleviate the unemployment problem. While we are totally sympathetic to the need to create jobs, we are opposed to doing so by such clearly inefficient means as make-work projects. However, we do believe that a program to accelerate selected infrastructure projects would be highly desirable. For example, an early resolution of the Crow's Nest railway rate issue, and an accompanying acceleration of improvements in the railways planned for the next several years, would be reasonable and appropriate. Such initiatives would largely leave the actual provision of jobs in the private sector - where such activity belongs - while at the same time providing a push to the manufacturing sector. An initiative of up to $500 million would be appropriate here.

In advocating these stimulatory measures, the Chamber is acutely aware of the current size of the federal deficit, and of the fact that, as we have said on numerous occasions in the past, a reduction in the deficit is a sine qua non for long-term health of the economy. In view of this, we were encouraged by the fact that, in October, you stated that job creation programs were to be financed by funds reallocated from other, less urgent programs. While a start has been made at reallocation, however, we believe that more must be done. In particular, any accelerated infrastructure programs or other direct job creating initiatives must be funded by reallocation of funds from other programs.

To accomplish this reallocation, the Chamber believes that the government must prioritize existing programs, then reduce or eliminate those programs that receive the lowest priority under existing circumstances. The Chamber is not impressed by the argument advanced by some that "there is nowhere left to cut". To be sure, the goals of many, if not all, programs are good. But, just as businesses must forego attractive investment opportunities when funds are insufficient to finance them, or as individuals must give up consumer purchases when wants exceed the family budget, so too, the government must give up some otherwise good programs when the country cannot afford them. Moreover, it is not true that social services are the only place to cut, as some critics of the Chamber's position would claim. Social services is only one of several "envelopes" within the government's envelope system and if the priority list places all social services at the head of the queue, then other envelopes are available to take the reductions. (At this time, given the severity of the recession and the high level of unemployment, the Chamber of course does not suggest that you should cut any essential income maintenance programs). Only serious efforts to reduce the rate of growth in government spending will convince business and consumers that the government is serious in its

commitment to non-inflationary growth, and only an improvement in confidence will lead to the spending and investment necessary to generate a recovery.

In addition to prioritizing programs to reduce spending growth, the government might also sell off some assets to finance its programs and to reduce levels of indebtedness. This is the standard practice in the private sector: companies dispose of assets in an effort to raise capital during a liquidity crisis. We similarly encourage the government to seek every means to dispose of some of its Crown corporations. Sale of such companies - even partial privatization - would both bring in needed funds, and improve confidence. Moreover, privatization need not compromise social goals carried out by some of these corporations since other means of realizing the essential goals could easily be found.

Having said this, the Chamber recognizes that it is unrealistic and unreasonable to ask that all of the stimulatory measures we have proposed be fully funded by transfers from other spending envelopes.

Under the circumstances we would feel it reasonable that the proposed $2 billion retail sales tax reduction be financed by an increase in the deficit. We would endorse this for two reasons. First, the increase in the deficit would clearly be transitory if our proposal is adopted. In a recession such as we now experience, a transitory increase in the deficit is normally good economics. Second, since there will be an increase in economic activity as a result of this stimulus, part of the tax reduction can be expected to flow back to the government as a result of the higher level of economic activity. Thus while "crowding out" by governments in the capital markets worries us as a longer-term issue, it is not a concern with this specific proposal.

Monetary policy

"Nominal" interest rates have declined significantly since mid-year, but "real" interest rates are still high. Inflation in Canada during the last three months has been in the 7 - 8 percent range and is expected to move lower. In past recessions, the real rate of interest has often turned negative. While this may not be achievable or even desirable, given our current problems, a single-digit prime rate would be unlikely to rekindle inflation and would provide a much needed boost to interest-sensitive industries. Furthermore, lower longer-term rates would significantly help companies restructure their debt -- assuming of course receptive capital markets that anticipated no rekindling of inflation. In addition, it is unlikely that lower interest rates would lead to a weaker dollar, as U.S. interest rates are declining and are expected to fall further. The gap between Canadian and U.S. rates could be narrowed.

Having said this however, we should stress that the Chamber does not take any issue with the overall thrust of monetary policy recently followed by the Bank of Canada. In our judgement, the Bank was correct in choosing to follow U.S. interest rates rather than establishing a "made-in-Canada" interest rate policy. To have done otherwise would have added to domestic inflation, since the resulting drop in the exchange rate would have pushed up the cost of imported goods. In addition, serious distortions in our capital markets would have resulted, since the U.S. and Canadian financial system has become almost completely integrated in recent years.

What we are saying, though, is that there now appears to be room to permit Canada to follow U.S. rates down more rapidly, while at the same time maintaining a realistic and non-inflationary value for the Canadian dollar that will ensure that Canadian goods remain competitive in world markets. This ability to lower interest rates will be enhanced if fiscal policy is made more compatible with monetary policy.

OTHER POLICY MEASURES

Our suggestions on a sales tax cut, revision to the RHOSP program and an acceleration of infrastructure investment are clearly the most important measures that can be taken to improve the near-term outlook. However, as was indicated at the start of this submission, unless these policies are coupled with measures clearly directed at the longer-term problems facing the country, they cannot have the impact intended. The reason for this, once again, is that the low level of business and consumer confidence in Canada needs to be boosted, and only measures that make it clear that the government is also concerned about the longer term will provide that confidence. The specific areas where we believe policy changes are required are:

FIRA

By now it is abundantly clear that FIRA has had two negative effects. The first is that it discourages needed foreign investment in Canada. The second, is that it discourages domestic investment, as Canadian businessmen interpret it as one more example of a commitment to government interference in the economy. Despite the fact that the Chamber has applauded the recent changes in the administration of FIRA, we still believe that one of the fastest ways to improve the investment climate is to significantly modify the Act, to make it clear that foreign investors willing to be good corporate citizens in Canada are welcome and will be afforded equal treatment with domestic companies. At the same time, such a restructuring would go a long way towards convincing Canadian businessmen that the government is not wedded to an interventionist mode of operation. Some of the more important changes we would like to see are:

a. establishment of clear and precise criteria for assessing significant benefit to Canada. These criteria should be made public so that applicants know the basis on which their applications will be judged;

b. shortening and streamlining of the review process by raising the threshold of FIRA jurisdiction so as to reduce the number of applications, and by adopting the principle of automatic approval within a given time unless FIRA or the Cabinet had specific objections based on precise criteria;

c. elimination of extra-territorial aspects of FIRA by exempting from FIRA jurisdiction the transfer of Canadian assets from one foreign owner to another foreign owner as a result of changes in control of foreign parents;

d. working to change the perception that exists abroad that Canada does not welcome foreign investment by emphasizing that the role of FIRA is limited to ensuring Canadian benefit from foreign investment in accordance with clearly specified criteria.

Energy Investment

The world oil price outlook has changed considerably since the days when the National Energy Program was established. The combination of a number of factors have contributed to the postponment of many otherwise economic projects. These factors include: low forecast oil prices; the existing fiscal regime for energy; what are viewed as onerous back-in provisions on federal lands; and the punitive petroleum and gas revenue tax; as well as other measures hostile to many of the firms operating in the industry. We urge the government to devise, with the co-operation of the appropriate provincial governments, a new fiscal regime that would take account of the current price situation and that would breath new life into some of these shelved projects. With business spending hovering at record low levels a revival of the oil sector would provide a welcome stimulus to Canada's manufacturing industries.

We also urge the government to continue to work to resolve its differences with the government of Newfoundland so that stalled offshore exploration activity can proceed.

Export Incentives

Canada's export performance has been weak. The current trade surplus is based on a big drop in imports rather than a surge in exports. Unless our export performance improves, we will slip back into deficit once economic recovery takes place.

The timing and the strength of the next economic recovery is heavily dependent on the ability of our exporters to penetrate foreign markets. However, Canadian exporters are at a serious disadvantage because Canada offers much less support in the form of export incentives than most major industrial countries. A recent study published by the Economic Council of Canada confirms this.

While the Chamber does not, as a rule, favor special government assistance to industry, we believe that the particular circumstances of the export sector justify government support. While the practice exists elsewhere, Canadian exporters should be accorded financial incentives similar to those received by their foreign competitors. In addition, we believe that there is much that the government could do to encourage and support product mandating by multinational firms. We urge you to begin immediately to explore with the business community initiatives that might be undertaken in this area.

Taxation Measures

The Chamber recognizes that lower corporate taxes, while desirable in a longer-term context, are not in general an avenue for immediate job creation. However, to help business produce and provide jobs in the long-term, the Chamber believes that the following measures should be undertaken:

a) the halving of the first year capital cost allowance has restricted new investment in plant and equipment and implementation of the changes should either be abolished or deferred for a two-year period;

b) the proposed Registered Shareholders Investment Plan should be implemented, as recommended by the Lortie Committee.

WHAT SHOULD NOT BE DONE

Equally important with what should be done in the short-term is what should not be done. In our judgement, the most important things not to do are:

1. Raise Personal or Corporate Taxes

While there is a great temptation to argue that high income individuals are largely savers, and that higher tax rates on these individuals could provide the funds to finance other expenditure programs, the Chamber is convinced that such reasoning is erroneous. High savings rates are a reflection both of high interest rates and a desire to repay debt and restructure balance sheets, as well as of low confidence in the economic future and in the reasonableness and predictability of government policy. Raising taxes would likely result in offsetting increases in savings as households attempt to restore the level of personal wealth they feel necessary. Moreover it would tend to serve to convince an already cynical public that their worst expectations were in fact justified. This in turn would exacerbate the tendency to pull back and retrench beyond what is justified by the state of the economy. Similarly, any increase in corporate taxes - for those firms still earning enough to be paying them - would further exacerbate the problem of low business confidence.

2. Revise and Tighten the RRSP Program

Recently the press has printed what we can only assume were "trial balloons" suggesting that the RRSP program might be revised and tightened in the next budget, making it more difficult to collapse an RRSP, and introducing other restrictions on the program. In our judgement any such changes would be a mistake. As we have said in the past, it is essential if confidence is to be restored, that

business and individuals be able to anticipate some degree of consistency and predictability in the tax regime. To tighten as basic a program as the RRSP would convince almost everyone, we believe, that no such consistency and legislative stability can be expected. Instead, it would encourage the belief that the government cannot resist the temptation to change for the sake of change whenever the opportunity presents itself.

3. Further De-Index Personal Income Tax

It is obvious that at the present time across-the-board tax increases are not warranted. Less commonly understood, it would appear, is the fact that de-indexation represents a tax increase. The Chamber deplored the partial de-indexation of the personal income tax in Mr. MacEachen's last budget. We would vociferously oppose any further restrictions of the indexation of the personal income tax. In fact, we would favour an immediate restoration of full indexation. However, since we recognize that this is not practical at this time, at a minimum we believe you should reaffirm the government's commitment that the partial capping introduced last spring is indeed a temporary measure that will not extend beyond 1984, at which time full indexation will be restored.

As we have stated in previous submissions, the Chamber believes that indexation of the personal income tax provides a vitally needed element of equity to our tax structure. As such it is not hard to see why the public cynicism and suspicion of government would be increased by even partial de-indexation. Conversely we would expect a positive response to restoration of full indexation.

THE TAX SYSTEM

The government has said on a number of occasions that it intends to give the taxpayer "a holiday" from the usual great number of technical amendments. We agree with the principle of this approach, since the business community and its advisors need a breathing space after the events of the past fourteen months. This does not, however, mean that tax measures to bolster business investment should not be considered. We have dealt with a number of these in other parts of the submission.

Although we will not make detailed suggestions at this time, it is our intention to present a detailed submission to the government on income tax legislation in May or June of 1983 and we hope that the government would then be able to give consideration to our comments in time for the subsequent budget.

Nevertheless, we would like to make a few general comments on the question of income tax legislation.

We have expressed our view on previous occasions that the post-budget process is now grossly over-extended. We hope that we will not see again a situation where legislation is passed in 1983 relating to the 1981 taxation year. We believe that the government should adopt an approach where draft legislation is tabled on budget night. We are appreciative of the change in approach taken for Bill C-139 where detailed explanatory notes were released. We believe this approach should be followed in the future, and even be amplified, making it much easier to react to the draft legislation in a timely fashion.

We believe that it is generally agreed that the Income Tax Act has become too complex in the past few years, especially in the areas relating to small business. The reason why this has occurred is not difficult to establish; every budget in the past few years has added another layer of complexity onto those which have gone before, so the whole system is now virtually staggering under its own weight.

The successive waves of amendments have arisen from a tinkering approach to the system whereby an amendment is introduced whenever an abuse is perceived. However, sometimes memories are too short and a practice which was originally fully intended by government later becomes described as an anomaly, often over an alarmingly short period of time. For example, a reading of the Honourable Donald S. Macdonald's Budget of March 31st, 1977 indicates clearly that the enrichment of the dividend tax credit introduced in that year was intended to apply to small businessmen and was clearly intended as part of a number of changes introduced in that Budget designed to simplify the system. However, in a relatively short period of time, that position has been forgotten, the incentive became an anomaly, and we now have the corporate distributions tax.

It is certainly true that a tax system in an industralized country like Canada must be complex, but we believe that a business person is entitled to earn income, pay tax on the income and declare dividends under an understandable set of rules.

The Chamber appreciates the government's extensive use of the consultative process, and we feel that if the government continues this approach, a great deal of the unpleasantness and misunderstandings which have arisen in the past fourteen months will be avoided in the future. In this area, we believe that the government should meet the problems of budget secrecy directly by referring the question to Parliament for the establishment of specific guidelines. In addition, as we have said in the past, we urge the government to appoint a Tax Advisory Council to advise the government in all aspects of the tax system and the likely reaction to proposed changes.

For the reasons noted above, this submission will not make detailed comments on inflation accounting. However, as was already mentioned, the Chamber believes that the present system of indexing in the Income Tax Act is well founded and should be returned to its full level as quickly as possible.

In addition, we believe that studies should proceed, following on the groundwork laid by the Lortie Committee, in order to arrive at a system which does not tax illusory profits. We will have more detailed comments in our spring tax submission.

LONG-TERM STRUCTURAL PROBLEMS

The above discussion addressed short- and medium - term issues. However, there are a number of long-term structural problems that both the government and business will have to make every effort to resolve if Canada is to achieve sustainable, long-term economic growth. While not directly related to your forthcoming budget, three areas of concern, discussed below, are productivity, research and development and labor-management relations.

Poor Productivity Performance

Canada's productivity has been the worst of the seven major western countries. In 1982 Canada's productivity will probably have declined another 1.5 percent -- more than twice the decline forecast for our major trading partner. Equally disturbing is the fact that Canada's unit labour costs have been rising faster than the costs in the United States. Unit labour costs for all industries in Canada increased at an average annual rate of 12.5 percent in the 1978-80 period compared with 10.4 percent in the U.S. The disparity in unit labour cost increases was even greater in the manufacturing sector where the Canadian figure was 14.0 percent compared with 9.8 percent in the U.S.

Productivity improvement must remain a key longer-term concern for both business and government. The disincentives to capital formation which presently exist will only impair productivity performance in the future.

Research and Development

Canada's R & D effort is meagre compared to that of other countries. Yet, R & D holds the key to the ability of our industries to adapt to change, to compete and prosper. Clearly business and government have an important role to play in bolstering Canada's R & D activity and in determining its direction. We would welcome an opportunity to explore this important area with you. We are particularly concerned about the recent philosophical change within the Rulings Division of Revenue Canada to restrict the amount of funds that could and should now be available for R & D.

Labor-Management Relations

The state of labour-management relations in Canada is poor. Much of the legislation (both federal and provincial) that surrounds them serves simply to perpetuate and to increase our dismal record and our lack of competitiveness. Canada has one of the worse strike records among the major western countries. Moreover, the system tends to produce wage settlements that are less responsive to existing economic realities than in the U.S.

For instance, wage settlements in the U.S. began to decelerate much sooner than in Canada during the recent recession. This tendency makes Canadian industries less able to compete in the U.S., forces down the exchange rate, and encourages the government to maintain higher interest rates.

Because of the far-reaching implications for the economy, every effort must be made to improve the system and to ensure that it adds to the well-being of all Canadians.

THE CANADIAN CHAMBER OF COMMERCE

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A voluntary national federation of community and business leaders dedicated to the promotion and development of good citizenship, good government, and a strong and vital economy.